Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Madison River Telephone Company, LLC	)	WC 02-371
Tariff FCC No. 1, Transmittal No. 9	)	

DIRECT CASE

Madison River Telephone Company ("MRTC" or "Madison River") hereby submits its Direct Case and responses to the issues set for investigation in the FCC's *Designation Order*[1] associated with MRTC's Transmittal No. 9. Herein, MRTC provides additional evidence that MRTC's proposed tariff revisions are just and reasonable and should be permitted to take effect.

I. INTRODUCTION AND SUMMARY

MRTC maintains its traffic sensitive interstate access tariff (MRTC Tariff FCC No. 1) on behalf of two of its subsidiaries, Gulf Telephone Company ("Gulftel") and Gallatin River Communications, LLC ("Gallatin River"). Collectively, Gulftel and Gallatin River are referred to as "MRTC," "MRTC Companies" or "the Companies"). On September 24, 2002, MRTC filed proposed tariff revisions designed to recover uncollectible expense associated with uncollectible reserves set up for uncollectible access revenues. On October 1, 2002, AT&T filed a "Petition to Reject or Suspend and Investigate," and on October 8, 2002, the Commission suspended the proposed revisions and instituted an investigation into their lawfulness. Subsequently, on November 25,

[1] Madison River Telephone Company, LLC, Tariff FCC No. 1, Transmittal No. 9, WC Docket No. 02-371, DA 02-3284 (released November 25, 2002) (*Designation Order*)

2002, the Commission issued an order directing Madison River to submit a "direct case" to support its rate increases, including the provision of answers to a number of questions and certain specific data.

The proposed rate revisions are necessary for the Companies to achieve their authorized rate of return for the remainder of the 2002/2003 Tariff period. This is demonstrated by the insertion of the uncollectible expense used in the mid-course tariff filing into the Tariff Review Plan ("TRP") spreadsheet that was developed for the 2002 annual filing. The results show that, without additional revenues to compensate for the uncollectible expense, Gallatin River will earn 10.11% on its interstate Switched Access Services and 10.49% on its interstate Special Access services. Gulftel, without the rate adjustments, will only earn 9.06% on its interstate Switched Access Services and 10.75% on its interstate Special Access Services. Accordingly, the proposed increases are just and reasonable in all respects and must be allowed to take effect.

The legal basis for approving the proposed revisions is straightforward. Incumbent Local Exchange Carriers (ILECs) are allowed to recover their reasonable interstate expenses through tariffs filed under the Commission's Rules. Section 36.216 of the Rules provides for an allocation of Account 5300 "bad debt" expense to the interstate jurisdiction on the basis of Account 1181, Accounts Receivable Allowance-Telecommunications. Since Gulftel and Gallatin River file tariffs under part 61.38 of the Commission's Rules, they are required to forecast their expenses, investment and demand in support of their rates. The question, therefore, is whether these uncollectible expenses, which Gulftel and Gallatin River are currently accruing monthly, are reasonable.

MRTC's establishment of an appropriate uncollectible reserve is in accordance with generally accepted accounting principles. Furthermore, the establishment of such a reserve is a demonstration of responsible accounting because MRTC is recognizing, for financial purposes, a realistic reserve against receivables from access customers -- an effort to recognize only those revenues that realistically are expected to be collected. MRTC has no desire to overstate profits by failing to recognize that not all billed revenue will be collected.

Neither of Madison River's subsidiaries currently holds a deposit related to interstate access services. And, while certain alternative approaches to raising rates might be helpful in reducing the level of uncollectibles, there can be no guarantee that they will eliminate the risk of defaults and resultant bad debt. Thus, to the extent that advance payments, shorter notice periods for termination of service and other approaches might be embraced, MRTC's need for bad debt reserves could be reduced, but not eliminated. Thus, there are no alternatives that will achieve what the proposed rate increases will do, namely, permit the MRTC Companies to achieve their lawful rates of return.

MRTC will address each of the issues raised by the Commission, which are substantially similar to those raised in the Commission's Designation Orders for NECA's Transmittals No. 951[2] and 952,[3] hereinafter referred to as NECA's *Customer Deposit Direct Case* and NECA's *Rate Increase Direct Case,* respectively.

[2] National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 951, WC Docket No. 02-340, *Order*, DA 02-2948 (released October 31, 2002) ("*NECA Transmittal 951 Designation Order").*

[3] National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 952, WC Docket No. 02-356, *Order*, DA 02-3100 (released November 8, 2002) ("*NECA Transmittal 952 Designation Order").*

II. ISSUES DESIGNATED FOR INVESTIGATION

The Commission asks whether the increased allowance for uncollectibles and the resulting increases in interstate access rates are just and reasonable within the meaning of Section 201(b) of the Act.[4] Below, MRTC will respond to the specific questions posed by the Commission and demonstrate that the proposed increases are lawful.

1. *In support of its tariff filing, Madison River provided a detailed description of the method it used to estimate the level of uncollectibles. As part of its direct case, Madison River shall explain why it used 16 months rather than 22 months (which would reflect the remainder of the two-year tariff period) in determining the number of months to be used in calculating the monthly accrual of uncollectible interstate access revenues for its traffic-sensitive revenue requirement since the tariff period runs through June 30, 2004.*[5]

MRTC chose a 16-month period to establish a reserve for carrier uncollectibles in order to reach an adequate reserve level by the end of the 2003 calendar and fiscal year. This allows MRTC's financial statements to reflect adequate reserves by the end of the next full calendar year against reasonably projected bad debt expense. The tariff period established by the FCC for section 61.38 tariffs begins on July 1 and ends on June 30 of the following year.

Although MRTC believes that the approach it employed is reasonable, it recognizes that a longer period also would be reasonable. Had MRTC chosen to establish the reserves over a 22-month period, resulting in achieving targeted reserves by June 30, 2004, the proposed increase in interstate access rates would be reduced by approximately 27%[6].

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[4] *Designation Order* at Paragraphs 1 and 6.

5 *Designation Order* at Paragraph 7.

[6] (100%-16 months/22 months =27.27%)

2. *Madison River shall provide an analysis of uncollectible amounts from an historical perspective, as well as an analysis of current telecommunications market conditions. To that end, we direct Madison River to submit the level of uncollectible debts from interstate carrier access services along with the associated total interstate carrier access revenues and the actual return on investment for the years 1990 to the present. For the period from January 2000 to July 31, 2002, Madison River shall also provide the totals of each of the individual defaults grouped into the following ranges: less than $100,000; $100,001-250,000; $250,001-$500,000; $500,001-$1,000,000; and more than $1,000,000. For each range, Madison River shall indicate the number of defaulting entities.*[7]

Gallatin River began operations in November 1998, so its data reflect operations only from that time forward.

Gallatin River Data:

Year	Interstate Carrier Access Uncollectibles	Interstate Carrier Access Revenues	Interstate Rate of Return on CL Operations	Interstate Rate of Return on TS Operations	Interstate Rate of Return on Combined Operations
1998	$0	$1,513,634	11.39%	14.05%	N.A.
1999	$0	$7,868,353	10.98%	12.49%	N.A.
2000	$439	$14,533,000	N.A.	N.A.	10.43%
2001	$2,085	$14,581,000	N.A.	N.A.	13.60%
2002	$402,188	N.A.	N.A.	N.A.	N.A.

Gulftel Data:

Year	Interstate Carrier Access Uncollectibles	Interstate Carrier Access Revenues	Interstate Rate of Return on CL Operations	Interstate Rate of Return on TS Operations	Interstate Rate of Return on Combined Operations
1990	N.A.	$4,836,826	11.54%	11.35%	N.A.
1991	N.A.	$5,732,638	12.00%	10.83%	N.A.
1992	N.A.	$7,043,582	13.29%	13.39%	N.A.
1993	N.A.	$8,790,880	12.60%	13.74%	N.A.
1994	N.A.	$9,300,971	11.01%	12.06%	N.A.
1995	N.A.	$8,977,555	9.73%	11.98%	N.A.
1996	N.A.	$9,045,309	10.42%	12.12%	N.A.
1997	N.A.	$10,834,239	10.83%	11.85%	N.A.
1998	N.A.	$15,164,425	11.39%	14.05%	N.A.

[7] *Designation Order* at Paragraph 6.

1999	N.A.	$14,952,632	10.98%	12.49%	N.A.
2000	N.A.	$14,792,000	N.A.	N.A.	12.13%
2001	$1,658	$14,638,000	N.A.	N.A.	15.29%
2002	$487,856	N.A.	N.A.	N.A.	N.A.

For the period January 1, 2000 through July 31, 2002, Gallatin River experienced payment defaults by three carriers in amounts of less than $100,000 and one default for carriers in the category between $250,000 and $500,000. During the same period, Gulftel experienced a default by one carrier of less than $100,000 and a default in the category between $250,000 and $500,000.

Since January 1, 2000, Gallatin River uncollectibles due to bankruptcies amounted to $788,602, of which $0 has been recovered. For the same period, Gulftel uncollectibles due to bankruptcies were $593,292, of which $0 has been recovered.

The percentages of 2001 revenues from IXC, CLEC and ILEC access customers for Gallatin River were 99%, 1% and 0%, respectively. The percentages of 2001 revenues from IXC, CLEC and ILEC access customers for Gulftel were 100%, 0% and 0%, respectively.

For the period January 1, 2001, through June 30, 2002, the percent of default amounts at Gallatin River was 71% for billing in arrears and 29% for services billed in advance. For the period January 1, 2001, through June 30, 2002, the percent of default amounts at Gulftel was 94% for billing in arrears and 6% for services billed in advance.

Gulftel has been a member of the NECA Common Line since its inception in 1984 and continues to participate in the NECA Common Line Pool. Gulftel participated in the NECA Traffic Sensitive pools from 1990 (and earlier) through June 30, 2000.

Therefore, for calendar years 1990 through 1999, Gulftel earned the same returns as the NECA pools. These are reflected in the table above. For calendar years 2000 and 2001, the tables above show the combined rates of return filed in the Company's latest FCC Form 492 Rate of Return report. Except for the year 2001, both Gallatin River and Gulftel have been participants in the NECA pools for all or part of each year. Therefore, the history of rates of return shown for Gallatin River and Gulftel only reflect a single year of operations entirely under their own tariffs.

Gallatin River was formed and began service in November 1998.[8] Gallatin River joined the NECA Common Line pool when it began service and continues to be a member of the NECA Common Line pool. It joined the NECA Traffic Sensitive pool in November 1998 and remained a member until it filed its own interstate Traffic Sensitive tariff, effective July 1, 2000. Therefore, Gallatin River earned the same return during 1998 and 1999, as did the NECA pools. For calendar years 2000 and 2001, the table shows the combined rates of return filed in the Company's latest FCC Form 492 Rate of Return report.

3. *Madison River shall then address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks anticipated in the 11.25 percent authorized rate of return, or whether it reflects some long term trend that warrants increasing the allowance for uncollectibles in the calculation of Madison River's interstate revenue requirement.*[9]

There are a number of evident long-term trends that lead to marketplace instability and, therefore, warrant increasing the allowance for uncollectibles in the

[8] Gallatin River Communications was purchased from Sprint.

[9] *Designation Order* at Paragraph 7.

calculation of MRTC's interstate tariff rates.[10] Several of these trends are described in detail in NECA's Customer Deposit Direct Case[11]. The following trends, individually and collectively, influence MRTC's need to increase the allowance for uncollectibles: 1) reduction in IXC switched access revenues due to substitution by cellular offerings with unlimited night and weekend calling, and with bundled long distance included; 2) reduction in per-minute IXC rates and profits due to intense competition; 3) reduction in debt ratings of access customers;[12] 4) reduction of switched access revenues due to the substitution of e-mail and voice and other communications services using the Internet: and 5) the concentration of competitive local exchange carriers on high volume customers often resulting in the reduced use of IXC services on LEC networks by these customers.

4. *Madison River should expand on its analysis of the risk of default among its customers. Madison River should indicate whether the increase is expected to cover the default of several smaller customers or one or two bigger ones.*[13]

Recent experiences demonstrate there are no reliable indicators of which carriers will default on their payment obligations for essential access services, or when they will do so. WorldCom provides a good example of this unpredictability. Prior to its

[10] It would serve no useful purpose here to cite to the hundreds of press and analyst reports disclosing the state of ill health in the interexchange industry, not to mention alarms raised by the Commission itself. See, *e.g.*, "Financial Turmoil in the Telecommunications Marketplace: Maintaining the Operations of Essential Communications." Written Statement of the Honorable Michael K. Powell, Chairman, Federal Communications Commission, before the Committee on Commerce, Science, and Transportation, United States Congress, July 30, 2002.

[11] *See* NECA's Customer Deposit Direct Case, pages 14 through 17.

[12] *See* NECA Customer Deposit Direct Case, Exhibit B. For even more recent examples; on December 9, 2002, Moody's Investor Service cut its rating Cable & Wireless debt to "Ba1" from "Baa2". Separately, Standard & Poor's Ratings Service warned it might follow Moody's lead and trim its own debt rating on Cable & Wireless. On the same day, Standard and Poor's Ratings Services announced that on December 6, 2002, it had lowered its corporate credit rating on Broadwing, Inc., to "single-B-minus" from "double-B". Both Cable & Wireless and Broadwing are access customers of MRTC.

[13] *Designation Order* at Paragraph 7.

precipitous plunge into bankruptcy, WorldCom's payment history was generally adequate and did not necessitate the use of tariff provisions requiring deposits and/or service terminations. This was the case until WorldCom suddenly stopped paying its bills and filed for bankruptcy protection before the current tariff provisions allowed for implementing protective measures or terminating service. Significantly, WorldCom representatives were stating -- until the last business day before bankruptcy was declared -- that WorldCom was financially sound and would not be filing for bankruptcy. Therefore, historical payment patterns and contemporaneous company representations cannot be relied upon and serve as no indicator of likely or possible default. It is important to note in this regard that both Qwest and Sprint have adequate payment records currently, but they also have been the subjects of widely publicized financial problems. Do they pose a risk of default within the current tariff period? Indeed, they do, and the better approach to dealing with that risk would be to allow MRTC to adjust its rates to accommodate that risk.

To deal with the difficulty of predicting which carriers will default and which will not, MRTC developed a model that assigned default probabilities to large and small carriers and included a weighted-average expected default ratio.[14] This model was developed to deal with the new external environment facing LECs today, as discussed above. The Companies decided to begin monthly bad debt expense accruals to establish a reserve for uncollectibles. (This process is similar to the one used with end-user customers.) Section 36.216 of the Commission's Rules states that the amounts in Account 5300 should be apportioned based on an analysis of Account 1181 for a

[14] *See* "Description and Justification" filed with MRTC Transmittal No. 9, which is incorporated herein and made a part hereof.

representative period of time. The result of this effort yielded an unrecovered expense in the interstate jurisdiction, as further described in a "days of risk" analysis.

In order to determine the amount of carrier revenues at risk when a carrier defaults, MRTC performed an analysis of the number of "days at risk" based on the time between when service is provided and when a carrier must pay or be disconnected. The "days at risk" were calculated based on operational and tariff considerations. As switched access is billed in arrears, the average age of a switched access record at the end of the switched access bill period is thirty divided by two or fifteen days. To this is added five days, which represents the time between usage cut-off and the actual bill date. As bills are not due and payable until thirty days after the bill date, thirty days was added to the calculation. If a carrier has not paid an invoice by the due date, it receives a phone notice within three days of the due date. The initial written late payment notice is sent five days after the due date. Disconnection notices are sent, on average, twenty days after the initial payment notice. The tariff notice period for service disconnections is thirty days. The "at risk" period is calculated as follows: for Switched Access, 15 + 5 + 30 + 5 + 20 + 30 = 105 days; and for Special Access, 30 + 5 + 20 + 30 = 85 days. The difference between these results from the fact that switched usage is billed in arrears, whereas special access is billed in advance. Therefore, the difference is the average age of the messages at the end of the switched access bill period. The Companies believe that these calculations most accurately reflect their true exposure.

To determine the likely amount of carrier uncollectibles, certain assumptions were made with regard to the likelihood of carriers declaring bankruptcy and the percent of revenues owed from bankrupts that would be recovered**.** These assumptions were based on the best information available. In any event, the accuracy of these assumptions is not critical in the context of longer periods, as the accrual method of accounting will adjust for, and accommodate, greater or fewer uncollectibles, as well as greater or fewer cash recoveries from bankruptcies.

Uncollectible expense entries book an expense and establish a reserve. If that reserve is deficient, then the Company must increase future expenses to increase the reserve. If the reserve is excessive, then the expense will decrease, be eliminated, or even be reversed. Such revisions would be reflected in the tariff periods in which they occur. Actual write-offs will reduce the reserve and actual cash recoveries will increase it. If the direct write-off method, rather than the accrual method is used, then this self-correcting mechanism will not operate. Companies will forecast actual uncollectibles and, to the extent that actual results vary from forecasts, costs will be over-recovered or under-recovered. Generally Accepted Accounting Principles ("GAAP") require that the Companies' balance sheets properly reflect their assets and liabilities. To the extent that net receivables are understated because of an inflated reserve for uncollectibles, GAAP requires that the reserve be reduced. The reduction will result in reduced expenses that in turn will lead to reduced rate proposals in future tariff filings.

The Companies project they will receive an average of 12% of their pre-petition CABS billing at the conclusion of the WorldCom and Global Crossing proceedings. As discussed above, if this estimate is over or under-stated, this error will be corrected in future periods by increases or reductions to the monthly bad debt expense entry.

The methodology used to calculate a target reserve for carrier uncollectibles necessarily is based on calculations different from those used for end-user uncollectibles.

End-user calculations rely heavily on accounts receivable aging. This has proven to be a good predictor for end-users in the past, but MRTC does not believe that the same methodology should apply to carrier uncollectibles. This is because end-user billing involves large numbers of customers with relatively small receivables, while carrier billing involves a few customers with only a handful accounting for most of the charges billed. The Companies, therefore, decided to analyze the bad debt risk on a carrier-by-carrier basis.

A decision was made to establish an uncollectible reserve for carrier receivables. The uncollectible expense entry is an inescapable result of that decision. The results were based on an estimate of the amount of required reserves, less current reserves, divided by the number of months until the target date for the target reserve is established. In this case, the Companies' management set the target date to establish the reserve at December 31, 2003. The Companies are not seeking to recover the uncollectible expense associated with prior bankruptcies but, rather, are seeking to recover the difference between the current uncollectible reserve and the target reserve. Indeed, the Companies have already recorded uncollectible expense to establish a reserve and seek here only to recover the interstate portion of the additional accruals required to reach the reserve targets set by management.

The Companies use the accrual method of accounting for uncollectible expense for end user as well as carrier receivables. This approach is normal practice within the industry and provides several benefits. It is much easier to administer than direct write-offs, does not overstate earnings prior to the write-offs, and creates a mechanism that corrects for under-estimates and over-estimates of uncollectible expenses.

The accrual approach is much easier to predict than uncollectible expenses related to specific companies. In order to forecast carrier access customer uncollectible expenses using the direct write-off method, companies would need to predict not only which carriers would file for bankruptcy, and when, they also would need to project their exposure and recoveries. By using the accrual method of accounting, companies can make more accurate predictions of their expenses.

The uncollectible analysis performed by MRTC identified a target level of uncollectible reserves that would reasonably be expected to be adequate for access customer defaults. The use of this methodology is self-correcting. Based on updated risk analyses for various carriers and actual experience with defaulting carriers, the required level of bad debt reserves can be retargeted from year-to-year. Any changes in uncollectible expense associated with changes in the target reserves would flow through the Income Statement and be reflected in tariff rates required to recover the MRTC interstate access revenue requirements.

5. *In addition, Madison River shall explain how the three bankruptcies it cites, ITC-Deltacom, Global Crossing, and WorldCom, can provide a basis for determining any future uncollectible levels*[15].

The three recent carrier bankruptcies show that bankruptcies can be unexpected and sudden. The experiences also show that carriers will only pay their suppliers what is necessary to avoid termination of service and will use credit to the limit before filing for bankruptcy. Further, the experiences show that IXCs, in a bankruptcy court, will classify the LECs as "utilities", but then seek to convince the court there is adequate assurance of payment without deposits or other guarantees. As a result, LECs are generally vulnerable

[15] *See Designation Order* at Paragraph 7.

to further bad debt from carriers already in bankruptcy.

6. *Madison River shall explain why the assumption that the recovery of pre-petition billing for current bankruptcies will equal the 12% recovery projected for Global Crossing when calculating the target reserve for carrier uncollectibles.*[16]

The recovery of pre-petition billing for current bankruptcies is based on a weighted average estimate of 30% recovery on Global Crossing pre-petition billing and an estimated 5% recovery on WorldCom pre-petition billing.[17] It is reasonable to project that MRTC will eventually recover 30% of its Global Crossing pre-petition billing. Based on the misclassified costs on the WorldCom financial statements over the last three years and the nature of its assets and debt levels, there is no assurance it will emerge from bankruptcy, much less pay any of its pre-petition obligations. Therefore, a lower projection of recovery of pre-petition debt for WorldCom, as compared to Global Crossing, is reasonable under the circumstances.

7. *Madison River shall also indicate the total dollar amount of security deposits held by its carrier participants that are attributable to interstate access services and the percentage relationship of that amount to average monthly interstate access billings. Madison River shall then address how it factored those deposits into its calculation of the allowance for uncollectibles that should be accrued, and, if it did not consider those deposits, it should indicate the modifications to its allowance for uncollectibles that should be made.*[18]

Neither Gulftel nor Gallatin River currently holds deposits for any access customers. Madison River's tariff provides for deposits under certain circumstances, but access customers generally have not met the conditions that would warrant the seeking of deposits. As described above, even carriers that ultimately filed for bankruptcy

[16] *Designation Order* at Paragraph 7.

[17] These estimates are for settlement of undisputed charges and do not include the cost of recovery and the time value of money.

[18] *Designation Order* at Paragraph 7.

protection were not seriously delinquent in their payments until immediately prior to their bankruptcy filings. Unless the Commission allows LECs to substantially revise their current tariff deposit terms and conditions, no modification of MRTC's allowance for uncollectibles would be appropriate. Should the Commission authorize a change in deposit terms and conditions, such a change would invoke the self-correcting mechanism of the calculation of monthly uncollectible expense.

8. *Madison River shall provide the following data on the distribution of its revenues for calendar year 2001. First, Madison River shall indicate the share of its revenues that come from each of the following types of customers: IXCs, competitive LECs, other incumbent LECs through arrangements such as meet-point billing, and businesses.*[19]

Gulftel's 2001 access revenues from IXCs, competitive LECs, other Incumbent LECs and business were 100%, 0%, 0% and 0%, respectively. Gallatin River's 2001 access revenues from IXCs, competitive LECs, other Incumbent LECs and business were 99%, 1%, 0% and 0%, respectively.

9. *Madison River shall also indicate the extent to which it has a debtor relationship with its customers and how that may affect its credit risk, e.g., through offset in a bankruptcy proceeding.*[20]

As part of a massive effort to provide data to the WorldCom and Global Crossing Bankruptcy proceedings, MRTC analyzed its debtor relationships in an attempt to establish setoff rights even though, historically, bankruptcy courts have been reluctant to treat such rights expansively. And, although MRTC has affiliates that purchase services from both Global Crossing and WorldCom, set-off rights are not within the Companies' control since, under bankruptcy rules, no setoff rights are available to an ILEC if the

[19] *Designation Order* at Paragraph 8.

[20] *Id*.

existing business relationships are with *affiliates* of the ILEC rather than the ILEC itself.[21] Therefore, there appears to be no opportunity to reduce the ILEC credit risk through setoff mechanisms.

10. *Madison River shall also provide data covering the period from January 1, 2001, to June 30, 2002, on the percentage of revenues in default that are attributable to services billed in arrears and the percentage attributable to special access services*.[22]

For the period from January 1, 2001, to June 30, 2002, the percent of revenues in default that were attributable to services billed in arrears was 74 % for Gallatin River and 93 % for Gulftel. The percent of revenues in default that were attributable to services billed in advance was 26 % for Gallatin River and 7 % for Gulftel.

11. *Madison River should indicate the amount of unpaid bills of defaulting customers that have gone into bankruptcy since January 2000 and the percentage of that amount that has been recovered through bankruptcy proceedings.*[23]

Since January 2000, Gultel has had $489,514 of unpaid bills from defaulting carriers. None has been recovered through bankruptcy proceedings. Since January 2000, Gallatin River has had $404,712 of unpaid bills from defaulting carriers. None has been recovered through bankruptcy proceedings.

12. *If Madison River believes that the risk of uncollectible debts has increased permanently, it should explain what accounts for this change, e.g., the general economic climate or some structural change in the market. If the change is a structural one, are there methods other than its proposal to increase the allowance for uncollectibles that would adequately address this additional risk, e.g., is there a subset of carriers that can*

[21] It should be noted that until WorldCom is able to get its finances sorted out, given their vast disarray at this time, and until such time as it becomes clear which of the numerous WorldCom companies were involved in transactions with the Companies or their affiliates, the set-off scenario remains a possibility, albeit remote. In all events, the Companies reserve their rights to assert set-offs in bankruptcy court proceedings.

[22] *Designation Order* at Paragraph 8.

[23] *Id*.

be identified that are the major cause of the increased risk?[24]

As described in response to 3 above, there are a number of changes to the structure of the market, primarily resulting in less market share available to MRTC's interstate switched access customers as a whole. These changes impact all such providers. Therefore, there is not a subset of carriers that can be identified as the major cause of increased risk. MRTC believes that any deposit, advance payment and/or early termination provisions, in order to be effective, should apply to all carriers. For example, if MRTC had the ability to obtain advance payments from all access customers for services billed in arrears and, if it had the ability to terminate service for non-payment on 15 days notice, this would reduce maximum collection time for services billed in arrears by 45 days and for services billed in advance by 15 days. These provisions would have a corresponding impact on the amount of bad debt reserves required by MRTC and would result in changes to uncollectible expenses, due to the self-correcting nature of the MRTC uncollectible expense methodology. Advanced payments and shorter termination provisions would, of course, benefit most access customers as such provisions would reduce potential bad debt costs payable, thereby reducing the rates paid by non-defaulting carriers. Although AT&T believes bad debt costs should be recovered solely from defaulting carriers, unfortunately, this is not possible as a practical matter because, once the carrier is in default, it either lacks the wherewithal to pay its debt, or it is protected from having to pay by virtue of its bankruptcy status.

13. *Madison River should also discuss any other steps it might take to mitigate the risk. For example, could it adopt some form of advance payment for services currently billed in arrears and, if so, what modifications to its tariff and billing programs would be*

[24] *Designation Order* at Paragraph 9.

necessary? How difficult would it be to implement such changes?[25]

Madison River would consider adopting tariff provisions for advanced payment of services now billed in arrears. This would require modification of its tariff, however. Billing programs would also need to be modified and a periodic "true-up" procedure established, all of which have a cost to implement and operate. MRTC anticipates it is capable of developing appropriate access tariffs and billing modifications to allow for advanced billing for services billed in arrears.

14. *Finally, Madison River shall describe how, for ratemaking purposes, it addresses defaults occurring before the effectiveness of any tariff to ensure that any tariff revisions are not designed to recover losses due to earlier nonpayment events. (i.e., how does it avoid retroactive ratemaking?).*[26]

Madison River does not seek to recover specific write-offs. It seeks to recover the interstate allocation of an expense incurred to establish an uncollectible reserve. This provision will be required when either the bankruptcy is settled or the receivables are sold to a third party. This is the accrual method of uncollectible accounting and its use for ratemaking has two advantages. First, it is easy to forecast an accrual and, second, it has a self-correcting mechanism that will lower future rates if the initial accrual is set too high and, consequently, rates are set too high. Further, the accounting established for carrier uncollectibles is identical to accounting methods already established for end user uncollectible reserves and expenses.

MRTC's method of accounting for uncollectible costs is in conformance with Generally Accepted Accounting Principles.

Once the initial bad debt study is performed, the accrual is set and will remain

[25] *Id*.

constant until it is complete and/or the market or actual experience changes. Once the initial target reserve is established, a permanent, lower monthly accrual will be established and adjusted as economic conditions and actual uncollectibles dictate. To incorporate actual uncollectibles into rate making, companies would have to forecast which carriers would file for bankruptcy and in which period they would file. WorldCom's bankruptcy filing occurred within three weeks of the end of a tariff period. It could have easily been a few weeks earlier. If companies could have forecasted that WorldCom was going to file for bankruptcy protection and what their exposure would be, -- but were off by a month -- millions of dollars of uncollectible expense would have been included in the wrong period. Companies would have then been correct to include those same uncollectibles in calculating rates for the subsequent filing period. However, as a practical manner, the requirement to forecast specific company bankruptcies would result in a regulatory "Catch 22". Under this scenario, future defaults would only be includable if known in advance. However, recent history, as noted, discloses that defaults are sudden and unexpected. But, if the impact of a default is considered "retroactive ratemaking", then once an event is known, it is too late to include the costs for recovery in interstate access rates.

The self-correcting mechanism inherent in the accrual method of uncollectible accounting occurs when IXC accounts are actually written off. For example if a company establishes an uncollectible reserve with the expectation that it will recover \$0.05 per \$1.00 and the actual settlement is higher than expected, the uncollectible provision will be higher than required. The company would then reduce or even reverse

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[26] *Id.*

the uncollectible provision. That reduction in expense will be taken into account when setting future rates. This mechanism is not perfect but will, over time, produce reasonable equity between access providers and access customers.

III. OTHER ISSUES TO SUPPORT MRTC'S DIRECT CASE

At the time of its Annual Filing, MRTC filed historical and prospective cost studies and analysis of demand. The historical period, which was the calendar year 2001, had no defaults of any significance. During the six-month period between the historical period and the prospective period (January 1, 2002 through July 1, 2002), Global Crossing filed for protection under Chapter 11 Bankruptcy. At the time of the Annual Filing, this was considered an isolated event. There were no public perceptions of what was in store for WorldCom. Once the WorldCom situation became public knowledge, MRTC reevaluated its annual filing and concluded that its tariffs needed to include a component to cover its expected bad debt expenses during the tariff period.

Respectfully submitted,

/s/ Michael Skrivan
Michael T. Skrivan
Vice President- Revenues
Madison River Telephone Company

Dated: December 18, 2002

CERTIFICATE OF SERVICE

I, Donald J. Elardo, hereby certify that copies of the foregoing "Direct Case" were, unless otherwise noted, mailed, first-class, postage prepaid, on December 18, 2002, to:

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